A. The Costs of BOC Anticompetitive Behavior to Consumer Welfare Are High.

Neither the BOCs nor their principal expert report attempt to analyze the costs to consumer welfare of their anticompetitive behavior. The BOCs presumably did not address the issue because they believe that nonstructural safeguards are effective. The Hausman/Tardiff Report thus dismisses the benefits to competition from structural separation in less than half a paragraph.[47] The Hausman/Tardiff Report similarly does not analyze the effectiveness of the Commission's nonstructural safeguards. It, nonetheless, makes the sweeping conclusion that "all available evidence shows that these rules are working as intended and that the enhanced service market is thriving."[48]

Obviously Messrs. Hausman and Tardiff did not take into account the lengthy record of anticompetitive abuse that was placed before the Commission in the Computer III Remand Proceeding. Nor did they take into account the many well-documented cases of cross-subsidization and access discrimination that have occurred since that proceeding.[49] Clearly, "all available evidence" points to a conclusion different from that reached by Hausman and Tardiff. It is therefore difficult to understand how they can conclude that "[i]t is clear that any benefits to competition that may arise from structural separation are far

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[47] See Hausman/Tardiff Report at 3.

[48] Id. As discussed supra pp. 15-16, the existence of a competitive enhanced services marketplace does not prove that nonstructural safeguards are effective.

[49] See MCI Comments at 34-39; CompuServe Comments at 27-49; ITAA Comments at 44-54.

outweighed by the loss of benefits and extra costs we have identified which arise from structural separation."[50]

The costs to consumer welfare of anticompetitive behavior on the part of the BOCs takes many forms. The most obvious harm is the higher prices that users must pay for monopoly services because of cross-subsidization by the BOCs. Enhanced service providers are also directly harmed by losing business to the BOCs' enhanced service operations or by being driven out of business by the anticompetitive actions of the BOCs. Even in a thriving market, these harms are real because enhanced service providers lose incremental business to the BOCs, are unable to provide services to their customers, or cannot maintain a sufficiently large customer base to remain competitive due to access discrimination and cross-subsidization.

Consumers of enhanced services also suffer because of anticompetitive behavior by the BOCs. If the BOCs discriminate against competing enhanced service providers by providing them with poor service or low quality lines, the customers of those enhanced service providers bear the brunt of the BOCs' actions. If the BOCs are able to delay the introduction of new enhanced services by not making certain network features available until the BOCs' own enhanced service operations are ready to use them, consumer welfare suffers. Enhanced services customers also suffer from inefficient network-based solutions that the BOCs are able to utilize solely through cross-subsidization. If the BOCs prevent competitors from interconnecting to or using efficient network solutions, the public also suffers an efficiency loss.

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[50] Hausman/Tardiff Report at 3.

The total cost of such anticompetitive behavior, though difficult to quantify, is nevertheless significant. Fully competitive markets drive prices towards marginal costs, spur innovative new products and services, and give consumers choices in products and services. Whenever actions are taken to limit fully competitive markets, these advantages are reduced. The BOCs need not monopolize all enhanced services in order to have a dramatic effect on consumer welfare. Every anticompetitive act permits prices to be raised above marginal costs, allows inefficient service providers to dominate markets over more efficient rivals, and causes captive ratepayers to pay for inefficient enhanced service offerings.

In both the original Computer III proceeding and the Computer III Remand Proceeding, the Commission concluded that its nonstructural safeguard regime would be effective in preventing anticompetitive behavior in the enhanced services marketplace. Thus, the Commission did not find it necessary to analyze the harm to competition caused by the elimination of structural separation requirements. The long and sad history of abuses by the BOCs in the enhanced services marketplace, particularly since the lifting of the information services restriction in the MFJ, requires the Commission to weigh the costs of eliminating structural separation. If nothing else, California III should make clear that the Commission ignores evidence of anticompetitive abuse at its peril. The Commission should therefore conclude that the competitive injury resulting from the elimination of structural separation would be significant.

B. The Benefits of Integration Cited by the BOCs Are Overstated.

The BOCs contend that the integrated offering of basic and enhanced services creates efficiencies and avoids the administrative costs of creating and maintaining separate subsidiaries.[51] The purported benefits are derived from three types of efficiencies. The first is the one-time cost of creating a separate subsidiary and moving personnel and equipment related to that change. The second purported benefit is the ability to offer new and innovative services because of the purportedly lower cost of integrated enhanced services offerings. The last benefit is derived from information and market position that the BOCs have obtained as a result of their legally granted monopolies in local exchange services.

Administrative costs. In their analysis of the benefits of integration, Hausman and Tardiff cite a U S West study estimating the administrative costs of structural separation.[52] The study identifies one-time costs for labor to re-equip administrative buildings and relocate enhanced services facilities, capital costs for equipment, and ongoing costs for the lease of facilities.[53] These estimates do not withstand scrutiny. The capital costs of equipment -- such as computers, telephones and furniture -- should not increase in any significant way. Surely, U S West's basic and enhanced service employees are not sharing desks, telephones and the like. Presumably each employee has his or her own office

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[51] See Ameritech Comments at 14-15; Southwestern Bell Comments at 30-40; Bell Atlantic Comments at 15-19; NYNEX Comments at 27-28; BellSouth Comments at 51-66; U S West Comments at 8-15; Pacific and Nevada Bell Comments at 18-26, 71-76.

[52] See Hausman/Tardiff Report at 22-25.

[53] See id.

furniture and equipment. As employees are moved from an integrated operation to a separate affiliate, their equipment can go with them. There is absolutely no reason to purchase new equipment.

Likewise, the total amount of office space needed should not change significantly. Unless U S West's regulated operations are paying for excess office space, underutilized employees, and unused equipment, all of these expenses are currently being borne by the integrated operation. Total costs should not rise with structural separation.[54] If the BOCs have enhanced services equipment in their central offices, they can avoid the expense of relocating that equipment if the BOCs allow their enhanced services competitors to also collocate their equipment in the BOCs central office facilities. There is no reason why only the BOCs' unregulated operations should benefit from access to facilities paid for by users of regulated services.

The only real administrative cost associated with structural separation is the small one-time charge of relocating personnel and equipment.[55] The one-time costs associated with creating a separate corporate subsidiary are probably non-existent. The BOCs have multiple subsidiaries which they could use to offer enhanced services. For example, Ameritech is preparing, subject to Judge Greene's approval, to offer interexchange

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[54] See Hatfield Reply at 3.

[55] The Commission should not even take this expense into account. The commingling of basic and enhanced service operations by the BOCs has occurred pursuant to Commission orders that have been vacated by the Ninth Circuit. The Commission should not base its decision on costs that are related to undoing the effects of arbitrary and capricious decisions. Rather, the Commission should analyze costs and benefits on the basis of the legal system that is currently in effect, i.e., the Computer II structural separation regime.

services through a separate subsidiary.[56] Similarly, all of the BOCs will be using separate subsidiaries to provide interexchange services in conjunction with their wireless services.[57] And, if Congress passes any of the legislation now under serious consideration, the BOCs will need to use separate subsidiaries for their competitive services. The incremental costs, if any, of using such established subsidiaries for enhanced services should be minimal.

Benefits of integration. Both the Hausman/Tardiff Study and the BOCs themselves conclude that the significant growth of BOC participation in certain enhanced service markets is an indication of the benefits and efficiencies associated with the integrated provision of basic and enhanced services. These arguments ignore a far more significant event: the removal of the intraLATA information services restriction from the Modification of Final Judgment in 1988. Prior to 1988, the BOCs could not provide enhanced services in any meaningful way. Any growth from a zero basis is, by definition, dramatic.

Further, there is absolutely no evidence that integration has resulted in the introduction of any enhanced services that were not previously available or that the growth in these markets would not have occurred in the absence of BOC participation. The U.S. information services industry -- which is "structurally separated" from the BOCs' networks -- is today the world's largest and the fastest growing exporter in the U.S. economy. By

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[56] See Motion of the United States for a Modification of the Decree to Permit a Trial, Supervised by the Department of Justice and the Court, in which Ameritech Could Provide Interexchange Service for a Limited Geographic Area, United States v. Western Elec. Co., Civ. No. 82-0192 (D.D.C. Apr. 3, 1995).

[57] See United States v. Western Elec. Co., Civ. No. 82-0192, Order (D.D.C. Apr. 28, 1995).

contrast, those countries that have promoted the "integration" provision of basic and enhanced services lag far behind.

The calculations of lost consumer welfare cited by Hausman and Tardiff are premised on the assumption that if enhanced services are not offered by the BOCs, they will be otherwise unavailable. Although it is not surprising to hear such arguments from the BOCs and their experts, the fact remains that the introduction of new services and innovations in existing services have been provided mainly by independent enhanced service providers. If anything, the BOCs have been a restraint on innovation, due in part to their resistance to implementing true ONA.[58] It is clear that independent enhanced service providers would have been able to account for the strong growth in voice messaging services if the BOCs had been more forthcoming in providing the necessary underlying basic services.[59] More recent growth in these services is attributable to the introduction of technology that was not available at earlier times.[60]

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[58] See Hatfield Reply at 16.

[59] Most of the benefits of integration cited by the BOCs relate to their activities in the voice messaging market. The Hatfield Reply explains why the conclusions of Hausman and Tardiff relating to voice messaging do not take into account all of the relevant circumstances. See id. at 12-15. If the BOCs were to unbundle the local exchange network, these services would be provided as efficiently -- or more efficiently -- by independent ESPs. If the Commission finds that there are some efficiencies in the integrated provision of voice messaging and basic services, that alone does not justify wholesale removal of structural separation requirements. If the integrated provision of certain enhanced services would produce public benefits, the proper course of action would be to entertain a waiver request. It would be the opposite of reasoned decisionmaking for the Commission to abandon a highly effective regulatory regime on the basis of a single example that could be the subject of a waiver.

[60] See Hatfield Reply at 14-15.

The major efficiency discussed by the Hausman/Tardiff Study and the Teece Study relates to the economies of scope provided by integration.[61] The notion behind economies of scope is that there is excess capacity in existing services that can be used to provide additional services at little incremental cost. If the BOCs, for instance, have unused capacity in their networks, there are economies of scope in using the capacity to provide enhanced services.[62] This explanation, however, ignores the requisite caveat -- the unused capacity must exist in equipment that "is optimally sized and designed for other purposes."[63] As the Hatfield Reply points out, these "economies of scope" are more likely to be the product of unnecessary overinvestment in network equipment.[64] If the investment is unnecessary, regulated services are charged with the capital costs of the equipment and the BOCs' enhanced service operations can claim economies in incremental cost.

The BOCs and their experts also contend that consumers benefit from joint marketing and "one-stop shopping." It is not necessary to permit the BOCs to integrate their basic and enhanced services to obtain these benefits. If the BOCs would permit full resale of their services, resellers, enhanced service providers, and the BOCs' separate subsidiaries could give consumers the benefits of joint marketing and one-stop shopping without the risk

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[61] Hausman/Tardiff Report at 4-5; Teece Study at 3-4.

[62] See Teece Study at 3.

[63] Hatfield Reply at 2.

[64] Id.

of anticompetitive behavior that the BOCs' integrated operations pose.[65] This, however, is something the BOCs -- intent on preserving their monopoly -- refuse to do.[66]

Benefits from monopoly. The real "benefits" attributed by the BOCs to their integrated operations are the product of their monopoly in local exchange services. The Commission, however, should not consider these monopoly benefits in weighing whether to replace structural separation with nonstructural safeguards. The only concrete benefit which the BOCs have been able to identify is their ability to jointly market basic and enhanced services and to utilize information gathered from their basic service operations to market their enhanced services. In other words, the BOCs want to exploit their local exchange monopoly.

It is difficult to comprehend how the use of market power derived from a regulated monopoly can be considered an efficiency in a competitive market or a benefit to the public. The BOCs' claimed efficiencies -- which are the product of a government-granted monopoly -- would give the BOCs an unfair competitive advantage in the unregulated enhanced services marketplace. Rather than being a public benefit, it should, as the Ad Hoc Committee correctly points out, be considered a significant cost.[67] If the monopoly-generated information and customer relationships are to be viewed as a benefit, the BOCs are

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[65] Id. at 10.

[66] Joint marketing by the BOCs may actually be inefficient. Because the BOCs have access to captive local exchange customers, they may overmarket their services indiscriminately. Moreover, given the difficulty in accurately allocating the personnel and equipment costs of jointly marketed services, it is likely that ratepayers are subsidizing such overmarketing. See id. at 11.

[67] See Ad Hoc Comments at 9-10.

the only beneficiaries. For everyone else, the consequence of this so-called benefit would be harm to competition in the enhanced services marketplace. So long as there is no real competition in local exchange services, the Commission should not consider the BOCs' ability to exploit their position in local exchange services as a public benefit.

C. The Risks to Competition Outweigh the Costs of Structural Separation.

When the Commission conducts its cost-benefit analysis of structural separation and nonstructural safeguards, it should conclude that the inability of nonstructural safeguards to protect competition in the enhanced services marketplace is an enormous cost. It should similarly conclude that the benefits of integration are related mainly to the BOCs' monopoly position. By contrast, the costs of structural separation are few and the benefits many. Accordingly, the Commission should conclude that the public interest would be best served through the retention of the structural separation requirements of Computer II.

IV. THE COMMISSION SHOULD REJECT BELL COMPANY SUGGESTIONS THAT EXISTING SAFEGUARDS SHOULD BE WEAKENED.

In an apparent effort to divert attention from the benefits of structural separation, two of the BOCs, Bell Atlantic and Pacific Bell, have proposed that the Commission weaken some of its nonstructural safeguards. More specifically, Bell Atlantic and Pacific Bell would have the Commission eliminate the requirement that the BOCs obtain prior customer approval before using the CPNI belonging to customers with twenty or more lines. Additionally, Bell Atlantic would have the Commission shorten the network disclosure

requirement period, alter the Commission's cost allocation rules, and shorten the notice period for new ONA services. As ITAA and many other parties have demonstrated in their initial comments, the Commission's nonstructural safeguards are inadequate to prevent access discrimination and cross-subsidization as they currently exist. Weakening these nonstructural safeguards, as suggested by Bell Atlantic and Pacific Bell, would only create an additional threat to fair competition in the enhanced services marketplace. The Commission should therefore summarily reject these attempts to weaken its nonstructural safeguards and act to supplement these safeguards with a separate subsidiary requirement.

A. The CPNI Rules Currently Provide the BOCs With an Unfair Competitive Advantage.

Although the stated purpose of the Commission's CPNI rules is to prevent the BOCs' enhanced services operations from unfairly using the CPNI of their monopoly service customers,[68] the CPNI rules, in fact, provide the BOCs with preferential access to customer information. Unaffiliated enhanced service providers must obtain prior approval from customers in order to access their CPNI. The BOCs, however, are only required to obtain prior approval from customers with 20 or more telephone lines.[69] The BOCs require no prior authorization to use the CPNI of customers with fewer than 20 telephone lines.

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[68] See ITAA Comments at 29-31.

[69] Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, 6 FCC Rcd 7571, 7611-13 (1991) ("Computer III Remand Order"), vacated in part sub nom. California v. FCC, 39 F.3d 919 (9th Cir. 1994), cert. denied, 115 S.Ct. 1427 (1995).

Not satisfied with its present advantage, Bell Atlantic would weaken the CPNI rules further by permitting the BOCs to access the CPNI of all customers without prior authorization. Plainly, such action would harm competition. As the Commission has previously found, "unrestricted access to CPNI [would] give the BOCs an advantage over competing ESPs in marketing enhanced services to BOC customers."[70] Bell Atlantic contends that the primary advantage of its CPNI proposal would be to provide consumers with the benefits of "one-stop shopping."[71] The Georgia MemoryCall case, however, which the Commission ignored at its peril in the Computer III Remand Proceeding, demonstrates the anticompetitive dangers presented by such one-stop shopping and the misuse of CPNI.[72] Providing the BOCs with preferential access to CPNI would give Bell Atlantic's enhanced service operations a significant advantage in contacting potential new customers and in stealing existing customers from competing ESPs. Bell Atlantic has failed to explain why the Commission should not be concerned about such abuse.

Pacific Bell pursues another route in attempting to eviscerate the Commission's CPNI rules. Pacific Bell would have the Commission eliminate the CPNI rules with respect to "fully competitive network services."[73] The biggest problem with Pacific Bell's proposal is that there are no fully competitive local exchange services. As ITAA noted in its initial

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[70] Computer III Remand Order, 6 FCC Rcd at 7611.

[71] See Bell Atlantic Comments at 27.

[72] See Southern Bell Tel. & Tel. Co. Cost Allocations (Regulated/Nonregulated) and Affiliated Transactions (Ga. PSC June 4, 1991).

[73] See Pacific and Nevada Bell Comments at 70.

comments, the BOCs retain a near or complete monopoly in all local exchange services.[74] But even if fully competitive services were to develop overnight, Pacific Bell's proposal would be extremely difficult to administer. It would require the Commission to define fully competitive and then individually determine which network services and which locations are fully competitive. It would also require the BOCs to compartmentalize CPNI by service, something which may not be practical and which, even if practical, would be difficult to police. The Commission's resources are already stretched too thin without the additional burden of enforcing weakened CPNI rules.

If the CPNI rules are to be changed, they should be strengthened as demonstrated by the record in CC Docket Nos. 90-623 and 92-256. If the BOCs were required to obtain prior authorization before accessing the CPNI of any of their customers, not just those with 20 or more lines, the BOCs would not be disadvantaged. Rather, they would be on an equal footing with their competitors. To amend the CPNI rules as proposed by the carriers would give the BOCs a significant advantage in the marketing of enhanced services. The Bell Atlantic and Pacific Bell schemes, therefore, should not be entertained by the Commission.

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[74] See ITAA Comments at 37.

B. The Network Disclosure Rules Should Not Be Weakened.

As noted above, Bell Atlantic has proposed that the current network information disclosure period be reduced to one month from the current six months. Its proposal should be summarily rejected. Indeed, if any changes are to be made, the Commission should expand the minimum disclosure period beyond six months in order to give competing enhanced service providers access to network information at the same time that the BOCs' own enhanced service operations obtain such information.

The network disclosure rules were designed by the Commission to limit the competitive advantages which the BOCs currently enjoy because of their "ability to design new or modified network services that favor their own enhanced service operations."[75] Contrary to Bell Atlantic's assertion, the network disclosure rules do not merely require six months disclosure before the introduction of a new service. Rather, the BOCs are required to disclose network information at the make/buy point if the new service is to be introduced within twelve-months of that point.[76] The six-month notice requirement is a minimum requirement, with twelve months as the maximum.

As ITAA explained in its initial comments, the current six- and twelve-month notice periods leave enhanced service providers at a competitive disadvantage, because they give the BOCs a significant head start in designing enhanced services that interconnect with the regulated network.[77] The BOCs can use this network information in designing enhanced

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[75] Computer III Phase II Order, 2 FCC Rcd at 3088.

[76] See id. at 3086.

[77] See ITAA Comments at 31.

services long before any public disclosure is required. The existing six- to twelve-month notification period frequently does not give competing enhanced service providers sufficient time to design services that can interoperate with new or modified network services. A stronger network disclosure requirement is necessary merely to keep unaffiliated ESPs at an even position with the BOCs. Bell Atlantic's proposal to virtually eliminate the network disclosure requirement would only further increase the advantages which the BOCs now enjoy. Bell Atlantic's proposal should therefore be rejected.

C. The Cost Allocation Rules Should Not Be Altered.

Bell Atlantic has also suggested that the Commission should alter its cost allocation rules relating to joint and common costs.[78] In particular, Bell Atlantic proposes that joint and common costs should be allocated to its enhanced service offerings on an incremental cost basis, on the theory that its services -- both basic and enhanced -- are becoming increasingly competitive. The difficulty with Bell Atlantic's proposal is that it is based on a fundamentally flawed conclusion. Bell Atlantic's basic services are not now competitive, nor are they likely to become competitive in the near future. Thus, whatever cost formula might be appropriate in a competitive market is not appropriate for the BOCs' basic local exchange services. The Commission should therefore retain its current rules.[79]

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[78] Bell Atlantic Comments at 32.

[79] Bell Atlantic correctly notes that any reexamination of the Commission's joint cost rules would be a significant undertaking and should be accomplished in a separate proceeding. See id. at 32 n. 74.

D. The ONA Requirements Should Not Be Further Limited.

Bell Atlantic has also proposed that the Commission's ONA rules be revised so as to permit the BOCs to amend their ONA plans to reflect their use of a new basic service in connection with an enhanced service at the time of tariffing or thirty days prior to use, whichever is later.[80] Shortening the ONA notice period, as Bell Atlantic has suggested, would only serve to weaken the already ineffective ONA rules. As discussed more fully in ITAA's initial comments, if the Commission's ONA rules are to be changed, they should be modified to achieve the goals set forth in the original Computer III proceeding.

V. THE COMMISSION SHOULD REJECT ANY PROPOSED CHANGE IN THE DEFINITION OF ENHANCED SERVICES.

Perhaps the most fundamental change in the Commission's rules proposed by Bell Atlantic is the modification of the enhanced services definition.[81] More specifically, Bell Atlantic would redefine enhanced services to include only those services that change the content of the subscriber's transmitted information and exclude processing which alters the format, code, protocol, or other aspects of the subscriber's transmitted information.[82] The definition of enhanced services should be changed, Bell Atlantic contends, because of the development of fast packet data services, including Asynchronous Transfer Mode ("ATM"). These services are used to connect local and wide area networks which operate on different

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[80] See id. at 32-33.

[81] Id. at 33.

[82] See id. at 34-36.

protocols and, therefore, require protocol conversion. Bell Atlantic contends that these protocol conversions are most efficiently preformed within the network and that treating protocol conversion as an enhanced service will slow the development of these broadband technologies.[83] ITAA disagrees.

As a procedural matter, the Commission cannot, consistent with the requirements of the Administrative Procedure Act, redefine enhanced services in this proceeding without giving proper notice. The Notice did not raise the definition of enhanced services as an issue to be addressed in this rulemaking, and the Commission may therefore not consider such a change at this time.

On a more substantive level, the Commission has already considered -- and rejected -- the suggestion made by Bell Atlantic regarding the definition of enhanced services.[84] In Phase II of the initial Computer III proceeding, the Commission considered several alternatives that would have modified the definition of enhanced services, including the removal of protocol processing. At that time, the Commission determined that the public interest would be served by retaining protocol processing within the definition of enhanced services.[85] Bell Atlantic's comments do not raise any new issues which warrant revisiting the Commission's earlier decision.[86]

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[83] See id. at 35-36.

[84] See Computer III Phase II Order, 2 FCC Rcd at 3074-3082.

[85] Id. at 3081-3082.

[86] Rather than asking for a change in the Commission's rules, Bell Atlantic should seek a waiver to provide protocol conversion services relating to broadband fast packet data services on an integrated basis, if such a waiver can, in fact, be justified. Such a (continued...)

There are simply no sound reasons why the regulatory framework adopted in Computer II and affirmed in Computer III should be abandoned or changed. To the contrary, there are many benefits to be gained by maintaining the status quo. Not the least of these benefits is regulatory certainty. The present definition of enhanced services has been in effect since 1980.[87] During the course of the last fifteen years, the enhanced services definition has been considered, reconsidered, interpreted and explained by the Commission on numerous occasions.[88] It has also been upheld by the courts.[89] As a consequence, there is a substantial body of precedent regarding the scope of enhanced services, and the definition is by now well-understood. Moreover, numerous investment decisions have been, and continue to be, made in reliance on that understanding.

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[86](...continued)
waiver request would be similar to the one that the Commission granted the BOCs to provide asynchronous-to-X.25 protocol conversion on an integrated basis. See Waiver of Section 64.702 of the Commission's Rules (Computer II), 100 F.C.C.2d 1057, 1088 (1985). If Bell Atlantic opts to submit such a waiver request, the issue should be dealt with in that context, rather than disturbing the entire basic/enhanced services dichotomy.

[87] See Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), 77 F.C.C.2d 384, on recon., 84 F.C.C.2d 50 (1980), on further recon., 88 F.C.C.2d 512 (1981), on further recon., FCC 84-190 (released May 4, 1984) [hereinafter cited as "Computer II"].

[88] See, e.g., Applied Spectrum Technologies, Inc., ENF 85-6, Mimeo 5532 (released July 3, 1985); International Business Machines Corp., ENF 83-34, FCC 85-292 (released June 11, 1985); North American Telecommunications Ass'n, 101 F.C.C.2d 349 (1985); Communications Protocols Under Section 64.702 of the Commission's Rules and Regulations, 95 F.C.C.2d 584 (1983); Computer II, 84 F.C.C.2d at 53-61, 77 F.C.C.2d at 417-28; Computer III Phase II Order, 2 FCC Rcd at 3081-3082; North American Telecommunications Ass'n, 3 FCC Rcd 4385 (1988); Computer III Remand Proceedings, 7 FCC Rcd 909 (1992).

[89] See Computer & Communications Industry Ass'n v. FCC, 693 F.2d 198, 210 (D.C. Cir. 1982), cert. denied, 461 U.S. 398 (1983).

The existing basic-enhanced dichotomy is also conceptually sound. By expansively defining enhanced services and by narrowly limiting basic service to those offerings in which a subscriber's transmitted information exits the network in exactly the same way that it enters the network, the current definitional framework draws a logically defensible distinction between the two groups of service. Rather than attempting to classify services as either basic or enhanced depending upon whether there has been a change in content, the enhanced services definition results in two mutually exclusive categories of service that are based on objective criteria. The current enhanced services definition is therefore also relatively easy to apply. One need only compare the input bit stream with the output bit stream in order to make an objectively verifiable determination whether a service is basic or enhanced.

In addition to being well understood, conceptually sound, and easy to apply, the current regulatory framework has another important benefit. It has a structural bias toward the nonregulation and competitive provision of new and innovative services.[90] By broadly defining enhanced services and leaving them outside the scope of regulation, the basic-enhanced dichotomy avoids the unnecessary extension of regulation in markets where competition can maximize public benefits. As the Commission has repeatedly found, competition provides the public with substantially greater benefits than regulation in terms of efficiency, innovation and lower prices. Given the Commission's inability to forbear from

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[90] As the Commission explained in Computer II, one of the major benefits of excluding all enhanced services from Title II regulation is that its "regulatory authority is not automatically expanded with advances in technology and the types of enhanced services that can be offered." Computer II, 77 F.C.C.2d at 429.

regulation, the adoption of Bell Atlantic's proposal would require the needless tariffing of heretofore unregulated enhanced services. Were that to occur, there are many enhanced service providers that, because of corporate policy or other sound business reasons, would leave the industry.

The current definitional structure -- which limits the scope of regulation -- has also had a beneficial impact on the marketplace. Hundreds of new vendors have entered the industry and thousands of new and innovative services have been made available to the American public, all without the active involvement or intervention of the Commission.[91] An essential factor in the success of the basic-enhanced dichotomy has been the Commission's decision not to assert Title II jurisdiction over the potentially severable basic elements of an enhanced service provider's unregulated offerings. As a result of this decision, the development of new and innovative enhanced services has been driven by technology and marketplace forces, rather than by a need to conform to regulatory pigeonholes.[92]

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[91] Another advantage of retaining the existing basic-enhanced dichotomy is that most foreign PTTs have become familiar with the regulatory framework in the United States today. Indeed, several have moved to emulate various aspects of the basic-enhanced dichotomy. If the Commission were to modify that framework in a way which expanded regulation, it would send exactly the wrong signal and slow or reverse the trend towards liberalization and privatization in other countries. Such action would also adversely affect the ability of U.S. enhanced service providers to market their services to overseas customers.

[92] As the Commission correctly recognized in its Final Decision in Computer II, the "regulation of enhanced communications services would limit the kinds of services an unregulated vendor could offer, restricting this fast-moving, competitive market." Computer II, 77 F.C.C.2d at 434.

By contrast, there are no sound reasons why the Commission should adopt -- or even seriously consider -- the changes proposed by Bell Atlantic. If the Commission were to revise the definition of enhanced services, it would be creating unnecessary regulatory uncertainty and laying the predicate for future disputes. In place of the existing basic-enhanced dichotomy, in which an objectively verifiable change in the subscriber's transmitted information renders a service enhanced, Bell Atlantic would employ a definitional framework that turns on whether the content of a subscriber's transmission has changed. In other words, Bell Atlantic would draw regulatory distinctions between services on the basis of a subjective non-technical standard. Rather than being a simple test, the proposed definition would lead the Commission into a regulatory briar patch.

Bell Atlantic's proposal would also bring services now being provided on an unregulated and competitive basis under active Title II regulation. Stated somewhat differently, services now deemed to be enhanced would become communications common carriage. As a consequence, the number of services and service providers that are currently subject to regulation would increase exponentially. Such regulation would be totally inappropriate.

A prime example of the kind of enhanced service that would become subject to Title II regulation is electronic data interchange or EDI, as it is more commonly known in the computer services industry. Simply stated, EDI is the electronic transfer of documents from one computer to another. It is used to replace the manual processing of routine business documents (e.g., purchase orders, invoices, bills of lading, manifests, etc.) that

have been printed by one company's computer system, mailed to another, and entered into the compute system of a vendor or customer. The essence of EDI is protocol processing.

The principal value of EDI is not transmission, but rather the ability to convert the input received from one computer into a code and protocol that can be understood by the receiving computer, and in a format that reflects the routine business documents used by the receiving company. These code, protocol and format conversions, are by no means simple or incidental to the provision of basic transmission service. A sophisticated EDI offering requires the use of substantial computing power, both in terms of hardware and software. To permit a carrier to embed in its ratebase the facilities needed to perform these conversions -- which are wholly unrelated to communications -- and to provide these conversions as communications common carriage makes absolutely no sense.[93]

Classifying protocol processing as basic service would also work at cross-purposes with the Commission's resale and unbundling policies. If protocol processing could be offered as part of basic service, carriers would no longer be required to provide their competitors with basic transparent transmission capacity on an unbundled basis, nor would they be required to obtain the underlying facilities which they use pursuant to tariff. As a consequence, carriers would be in an ideal position to engage in a "classic price squeeze" with respect to their competitive service offerings.

Moreover, none of the other competitive safeguards deemed essential by the Commission would apply to a substantial group of competitive services. CEI and ONA, the

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[93] It would also be unlawful for the Commission to assert jurisdiction over what are in fact data processing services. See GTE Service Corp. v. FCC, 474 F.2d 724 (2d Cir. 1973).

cornerstones of the Commission's nonstructural regulatory framework, would not apply. Carriers would also be free to embed the software and equipment used to provide these services in their ratebases and finance their competitive endeavors on the strength of their regulated operations. Furthermore, none of the accounting safeguards prescribed by the Commission would come into play. Given the significant investment in hardware and software required to provide protocol conversion, this should be a matter of great concern. The carriers would also be free to leverage their control of bottleneck facilities and their access to customer and network information to promote their competitive, but basic, protocol processing services.

Allowing carriers to offer protocol processing as part of basic service would also tend to establish de facto standards for the marketplace. Because protocol processing would be provided with regulated equipment subject to longer-than-usual regulated depreciation schedules, the protocols supported by local exchange carriers would influence the selection of data processing and data communications equipment by users. This process would inexorably lead to de facto standards of the BOCs' creation, even though superior protocols and equipment might be available from competitive sources.

The regulation of protocol processing as a basic service would also have serious consequences for enhanced service vendors that market their services overseas. In particular, the reclassification of protocol processing as basic might lead many foreign PTTs to conclude that enhanced service providers are unlawfully operating "in the manner of an Administration." Were this to occur, U.S. enhanced service providers might be precluded from using international private lines. U.S. service providers, which now operate freely,

might also be required to negotiate operating agreements and share their revenues with foreign administrations in order to continue to provide currently available service.

Given all of the adverse consequences of Bell Atlantic's proposed redefinition of enhanced services, the Commission should summarily reject Bell Atlantic's proposal.

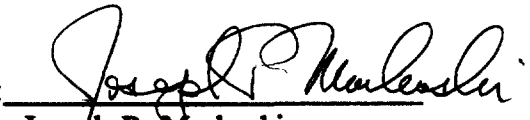
VI. CONCLUSION

As set forth above and in ITAA's initial comments, the Ninth Circuit's decision in California III requires the Commission either to accept Computer II or to undertake an entirely new analysis of the costs and benefits of structural and nonstructural safeguards. Upon conducting such an analysis, the Commission should conclude that the benefits of structural separation in preventing anticompetitive abuse far outweigh the one-time costs of establishing separate subsidiaries. Similarly, the increased risks of anticompetitive abuse which attend nonstructural safeguards far outweigh any perceived benefits of integrating the BOCs' monopoly local exchange and competitive enhanced service operations. The Commission should therefore require the BOCs to provide enhanced services through fully separate subsidiaries pursuant to Section 64.702 of its rules. The Commission should also reject the BOCs' proposals to weaken Computer III's already inadequate nonstructural

safeguards and to regulate currently unregulated services by changing the definition of enhanced services.

Respectfully submitted,

INFORMATION TECHNOLOGY
ASSOCIATION OF AMERICA

By: 

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